LIM HONG LIANG & ANOR

v.

TAN KIM LAN & ANOR

HIGH COURT MALAYA, KUALA LUMPUR
HAIDAR MOHD NOOR J
[CIVIL SUIT NO: D5-22-970-93]
11 APRIL 1997

CONTRACT: *Memorandum of understanding - 'Subject to contract' agreements - Whether legally binding - Construction of terms*

On 14 May 1993, the plaintiffs and the defendants executed a Memorandum of Understanding ('MOU') in anticipation of a takeover by UCM Industrial Berhad ('UCM') of certain target companies. The defendants were the shareholders and in control of UCM and the plaintiffs claimed to have control over the target companies which would be the subject matter of the takeover. UCM was not a party to the MOU.

This claim was an action taken by the plaintiffs seeking to enforce the terms of the MOU against the defendants and claiming compensation based on alleged breaches of the MOU by the defendants. The material paragraph of the MOU stated as follows:

> In consideration of the above premises, this Memorandum of Understanding hereby sets out the parties' understanding of some of the preliminary matters to be dealt with prior to the parties' finalisation of the terms and conditions of the formal agreements relating to the transactions hereby contemplated.

The transactions contemplated were set out after this clause. The defendants' defence was principally on the ground that the MOU, as the name signifies, was not a legally binding document. The issue before the Court was whether the MOU was a legally binding document between the parties.

Held:

[1] Pursuant to O. 33 rr. 2 and 5 of the Rules of the High Court 1980, the Court was empowered to determine the preliminary issue of whether the MOU was a legally binding document as the decision of such issue would in effect substantially dispose of the matter or would render the trial of the matter unnecessary.

[2] In construing whether a document has legal effect or not, the label attached to the document will not be the criterion for construing such a document. The duty of the Court is to construe the document as a whole and to determine from its language and any other admissible evidence its true nature and purport.

[3] The various clauses found in the MOU contemplated the necessity of getting approval from some relevant authorities as well as the Board of Directors and shareholders of UCM and the target companies. The MOU was therefore an agreement to contract or an agreement to negotiate. It would seem that the parties intended the MOU to be subject to a formal contract to be executed by both parties after the finalisation of the terms and conditions. The general principle is that when there is a fundamental matter left undecided and to be subject to negotiation, there will be no contract.

[4] Considering the totality of the terms and conditions set out in the MOU, the parties did not intend to create a legally binding contract in view of the various approvals that needed to be obtained and the various uncertainties and the process of negotiations that needed to be carried out.

[5] Assuming that the Court was wrong in finding that the MOU was not a legally binding document, on the facts of the case there were a number of uncertainties that needed to be sorted out by the parties that would require further negotiations. Hence, the MOU did not give enforceable right to the plaintiffs as claimed by them.

[Plaintiff's claim dismissed with costs.]

Cases referred to:

Sia Siew Hong & Ors v. Lim Gim Chian & Anor [1996] 3 CLJ 26 ***(refd)***
Addiscombe Garden Estates Ltd v. Crabbe [1958] 1 QB 513 ***(refd)***
Kleinwort Benson Ltd v. Malaysia Mining Corporation Bhd [1989] 1 All ER 789 ***(refd)***
Ayer Itam Tin Dredging Malaysia Bhd v. YC Chin Enterprise Sdn Bhd [1994] 3 CLJ 133 ***(refd)***
Crossley v. Maycock [1974] 43 LJ Ch. 379 ***(refd)***
Courtney & Fairburn Ltd v. Tolaini Brothers (Hotels) Ltd & Another [1975] 1 WLR 302 ***(refd)***
MN Guha Majumdeer v. RE Donough [1974] 2 MLJ 114 ***(refd)***
Walford v. Miles [1992] 2 WLR 174 ***(refd)***

Legislation referred to:

Rules of the High Court 1980, O. 33 rr. 2, 5

For the plaintiff - L Sabapathy (P Gananathan with him); M/s Logan Sabapathy & Co

For the defendant - KG Tan (YS Lim with him); M/s Tee, Tan & Partners

JUDGMENT

Haidar Mohd Noor J:

From the statement of claim of the plaintiffs in this writ of summons, it would appear that the claim is centred on the memorandum of understanding dated 14 May 1993 ('MOU') executed with the defendants. The defendants' defence is principally on the ground that the MOU, as the name signifies, is not a legally binding document.

When the action came for hearing before me, I indicated to both counsels that the issue – "whether the MOU is a legally binding document" be determined by the Court first as I was of the view that the decision of such issue would in effect substantially dispose of the cause or matter or render the trial of the cause or matter unnecessary (see O. 33 r. 5).

Both counsels agreed as the Court is empowered to determine the issue first as provided by O. 33 r. 2 of the Rules of the High Court 1980 ('RHC'). It reads:

> The Court may order any question or issue arising in a cause or matter, whether of fact or law or partly of fact and partly of law, and whether raised by the pleadings or otherwise, to be tried before, at or after the trial of the cause or matter, and may give directions as to the manner in which the question or issue shall be stated.

I accordingly directed the issue be tried first and the parties agreed and filed a common agreed bundle of documents ('CABD') for the purpose of determining the said issue. Both counsels put in written submissions.

The plaintiffs' Counsel submitted that the MOU can be divided into two parts namely:

(1) prescribes enforceable rights between the plaintiffs and the defendants in relation to the identification and introduction of profitable companies ('Target Companies') to be injected into U.C.M. Industrial Berhad ('UCM').

(2) prescribes the intended sharing of benefits consequent to the injection. The intended sharing of benefits consequent to the proposed injection envisages further discussions and agreements between the parties and consequently amounts to an agreement to agree which, in the absence of *mala fide*, is incapable in law of prescribing specifically enforceable rights.

According to the Counsel for the plaintiffs, part (1) gives the plaintiffs enforceable rights under the MOU. To that extent the MOU is a legally binding document.

Going by the contention of the plaintiffs' Counsel, it would be pertinent for me to examine the plaintiffs' prayers. Paragraph 10 of their statement of claim reads:

> By reason of the defendants' default of their undertakings and breaches, and the total failure of consideration on their part, the plaintiffs have suffered loss and damage.

And the plaintiffs' claim:

> (1) for the forfeiture of the said shares as the agreed compensation;
>
> (2) for an Order that the defendants do deliver to the plaintiffs all certificates relating to the said shares together with the duly executed transfer forms pertaining thereto;
>
> (3) costs of this action; and
>
> (4) such further or other relief as this Honourable Court shall deem fit.

The plaintiffs' claim therefore is essentially for compensation based on the alleged breaches of MOU and to that extent the MOU, according to the plaintiffs' Counsel, is a legally binding document. Further, as submitted by the Counsel for the plaintiffs, such claim is confined, according to him, to the first part.

Law

I agree that in construing whether a document has legal effect or not, the label attached to the document say, "memorandum of understanding" is not the criteria for construing such a document. In this regard, the Court of Appeal in *Sia Siew Hong & Ors. v. Lim Gim Chian & Anor.* [1995] 3 MLJ 141 in quoting with approval the case of *Addiscombe Garden Estates Ltd. v. Crabbe* [1958] 1 QB 513 at p. 528; [1957] 3 WLR 980 at p. 981) said at p. 147:

> No doubt it is described as a guarantee. But in the construction of contracts the Court is not bound by the labels that parties choose to affix onto the particular document. In all such cases the duty of the Court is clear. And that duty is to construe the document as a whole and to determine from its language and any other admissible evidence its true nature and purport.

It would then be prudent for me to consider the terms of the first part of the MOU and see whether the parties intended to enter into a legally binding relationship, the breach of which give rise to enforceable rights as claimed

by the plaintiffs. In other words the Court will have to determine from its language and any other admissible evidence its true nature and purport. In this regard the admissible evidence to be considered would be the CABD, which was agreed to by both parties for the purpose of determining the issue as framed.

In considering the MOU, it is appropriate for me to examine the opening paragraphs of the MOU so as "to ascertain what common intentions should be ascribed to the parties from the terms of the documents and the surrounding circumstances" per Ralph Gibson, LJ in *Kleinwort Benson Ltd. v. Malaysia Mining Corporation Bhd.* [1989] 1 All ER at p. 789).

After stating the recitals in the MOU, it is thereafter stated at p. 2 (p. 4 of "CABD"):

> In consideration of the above premises, this Memorandum of Understanding hereby sets out the parties' understanding or some of the preliminary matters to be dealt with prior to the parties' finalisation of the terms and conditions of the formal agreements relating to the transactions hereby contemplated.

The transactions contemplated are set out thereon.

From the above it seems to me that the parties intended the MOU to be subject to a formal contract to be executed by both parties after the finalisation of the terms and conditions. Until such time the MOU is not intended to be legally binding on the parties. In this respect, the Supreme Court in *Ayer Itam Tin Dredging Malaysia Bhd. v. YC Chin Enterprise Sdn. Bhd.* [1994] 2 MLJ at p. 765 said:

> But it is now well settled that when an arrangement is made 'subject to contract' (see *Rossdale v. Denny* [1921] 1 Ch. 57; [1921] 90 LJ Ch. 24) or 'subject to the preparation and approval of a formal contract' (see *Winn v. Bull* [1977] 7 Ch. D 29) and similar expressions, it will generally be construed to mean that the parties are still in a state of negotiation and do not intend to be bound unless, and until a formal contract is exchanged.

After having stated as above, the Supreme Court went on to consider a number of authorities with finally citing at p. 767 the case of *Crossley v. Maycock* [1974] 43 LJ Ch. 379; [1974] LR 18 Eq. 180 where Sir George Jessel MR said:

> If the agreement is made subject to certain conditions then specified or to be specified by the party making it or his solicitor, then until those conditions are accepted, there is no final agreement such as the Court will enforce.

It has to be borne in mind that the MOU was entered into by the parties individually as shareholders. No doubt the defendants were in control of UCM but UCM itself is not a party to MOU. As for the plaintiffs, they claimed to have control of various companies and purportedly proposed to arrange for the takeover of Target Companies by UCM without prescribing them in the MOU.

I do not think that it can be disputed that by the nature of the terms and conditions in the takeover of the Target Companies allegedly in control of the plaintiffs by UCM through the defendants, there would be the necessity of getting approvals from some relevant authorities as well as the board of directors and shareholders of UCM and the Target Companies. UCM is a public listed company. In this respect suffice for me to quote certain clauses in the MOU as to the need for approval:

Clause 1

Lim Hong Liang/Mohd. Nadzri shall use their best efforts to arrange for the sale to the company of the shares of such companies ...

Clause 2

Lim Hong Liang/Mohd. Nadzri agree to use their best endeavours to apply to all relevant authorities for their approval of the sale and purchase transactions referred to in cl. 1 above.

Clause 4

In the event that Lim Hong Liang/Mohd. Nadzri are of the view that the transactions contemplated by cl. 1 above are feasible, Lim Hong Liang/Mohd. Nadzri shall so notify the Owners and **thereupon the parties hereto will negotiate in good faith to finalise the terms of all relevant formal agreements as may be advised by Lim Hong Liang/Mohd. Nadzri's solicitors.**

Clause 7

The parties hereto acknowledge that in consequence of the transactions hereby contemplated and **in the course of negotiations relating to the finalisation of the formal agreements, each of them will receive confidential information relating to the company and the Owners**

Clause 8

The parties hereto agree that it is not feasible to provide for every contingency and that they have dealt with each other in good faith. **If any matter had not been dealt with herein, the parties hereto shall endeavour to negotiate in good faith with regards to such matter so that no undue hardship shall be caused to either party.**

Clause 9

> The parties hereto shall execute and do and procure all other necessary persons to execute and do all such further deeds assurances acts and things as may be reasonably required so that full effect may be given to the terms of this agreement. (emphasis added)

It would seem clear from the various clauses referred to by me that the MOU was an agreement to contract or an agreement to negotiate. In this respect Lord Denning MR in *Courtney & Fairburn Ltd. v. Tolaini Brothers (Hotels) Ltd. & Another* [1975] 1 WLR at p. 302 held:

> I think we must apply the general principle that when there is a fundamental matter left undecided and to be subject of negotiation, there is no contract.

In *M.N. Guha Majumder v. R.E. Donough* [1974] 2 MLJ 114 the learned Judge at p. 116 said:

> It is well established rule that the parties must make their own contract, and this means that they must agree to its terms with sufficient certainty. If the terms are unsettled or indefinite, there will be no contract (*Chitty on Contract* Vol. 1, 23rd Edn., para. 83).

Taking into consideration of the totality of the terms and conditions set out in the MOU, I am of the opinion that the parties did not intend to create a legally binding contract in view of the various approvals that needed to be obtained and the various uncertainties and the process of negotiations that needed to be carried out.

The plaintiffs' Counsel submitted that certain clauses in the MOU would give enforceable rights to the plaintiffs. Reliance was placed on the provisions in respect of time being of the essence of the contract and that the MOU shall be governed by the laws of Malaysia and parties agreed to the non-exclusive jurisdiction of the Courts of Malaya in Kuala Lumpur or Shah Alam.

Those provisions may tend to show that MOU was intended by the parties to be legally binding but if the essence of the MOU can be construed that the parties did not intend to be immediately bound then those provisions cannot negate such an intention for the reasons set out by me. In any event cl. 11 does not confine to the MOU only but extend to all collateral and/or related agreements.

In the circumstances I am of the view that the MOU is not a legally binding contract.

Assuming I am wrong in my finding that the MOU is not a legally binding document and that the Court should at least consider the first part of the MOU,

as contended by the Counsel for the plaintiffs, which give enforceable rights to the plaintiffs, I will next consider whether there are merits in such a contention.

The plaintiffs contended that the defendants committed two breaches namely, by not responding to the letter dated 3 June 1993 notifying the Target Companies and inviting the drawing up of the proposed sale and purchase agreements relating to the acquisition of the Target Companies.

A look at the letter dated 3 June 1993 (p. 10 of CABD) would clearly show that the three companies referred to and claimed by the plaintiffs to be under their control were not named therein. At most, they claimed to have the agreement in principle of the shareholders of the three companies. The said letter, *inter alia*, state that the total forecast pre-tax profits for the three companies are about RM9,800,000 for the year ending 1993. On completion of the restructuring of the three companies, the plaintiffs claimed that they anticipate RM35,000,000 would be raised and this would be sufficient to enable UCM to discharge a large part of its existing borrowings. It is to be noted, however, that no supporting documents were produced to show such projections. Quite naturally the defendants did not respond as without supporting documents, I do not see how the defendants can proceed to take the matter before their board of directors and eventually get their shareholders' approval. As UCM is a public company UCM will need to get the approval of the relevant authorities as well and there would therefore be a need to get the relevant information and documents to support the acquisition.

By cl. 2 of the MOU itself the plaintiffs agreed to use their best endeavours to apply to all relevant authorities for approval of the sale and purchase transactions referred to in cl. 1 (referring to sale to UCM of the shares of the Target Companies the plaintiffs claimed to have control). Quite apart from the alleged agreement in principle of the shareholders of the three companies for which no evidence in writing was shown to support thereof, there was no other evidence shown about the approval of the relevant authorities. It has to be borne in mind that this is not a straight forward sale and purchase of property or shares confining solely to individuals. It involves other parties, that is, other shareholders and relevant authorities as well. It is not a matter for the defendants to seek clarifications on the letter dated 3 June 1993. It is the plaintiffs' duty to show clearly in detail the shareholding of the three companies and they are in control as well as documentary evidence of the approvals from the board of directors and the shareholders of the Target Companies as well as the approvals of the relevant authorities. In a nutshell there are a number of uncertainties that needed to be sorted out and that would require further negotiations.

Even though time was made of the essence of the MOU, but in my view, time must be construed to the time required for the parties to take the preliminary steps towards the formalisation of the MOU. Even going by the time that was prescribed there were still a lot of things that needed to be cleared and sorted out and I do not think the defendants can be faulted for entering into negotiations with third parties. It is to be noted that the financial institutions were pressing with possible actions against them.

Actionable Breaches

The plaintiffs' Counsel submitted that the plaintiffs are entitled to rely on the first part of the MOU as their rights are prescribed therein as follows:

(a) the failure to consider the nomination of the Target Companies and the consequent failure to enter into *bona fide* negotiations in respect of the sale and purchase agreements with the Target Companies and

(b) the various *mala fide* acts relating to the clear negotiations with third parties despite the express lock-out provisions.

As regards (a), as I said earlier, the particulars provided therein are insufficient for the defendants to enter into negotiations for the reasons stated earlier on by me. In that respect, it cannot be said that the defendants were at fault. Therefore it does not give enforceable right to the plaintiffs as claimed by them.

As regards (b), the plaintiffs Counsel submitted that cl. 5 of the MOU is to be construed as a lock-out agreement citing *Walford v. Miles* [1992] 2 WLR 174 where the House of Lords considered the elements necessary to constitute a 'lock-out' agreement between the parties and at p. 182 said:

> There is clearly no reason in the English contract law why A, for good consideration, should not achieve an enforceable agreement whereby B agrees for a specific period of time, not to negotiate with anyone except A in relation to the sale of his property.

However, in *Walford v. Miles*, the agreements had all the essentials of valid "lock-out" agreement save one, that it was unlimited in time.

Even though time was prescribed in the MOU, it was no longer of the essence as there were a lot of uncertainties to be sorted out within the time prescribed. It would appear that the parties would not be able to resolve them within the time prescribed.

The plaintiffs' Counsel further relied on the case of *Radiant Shipping Company Ltd. v. Sea Containers Ltd.*, Court of Appeal (Civil division) 23 February 1993 (transcripted via "*lexis nexis*") which considered and distinguished *Walford v. Miles* regarding "lock-out" agreement. This is what Thorpe J said at p. 6 (p. 16 of the plaintiffs' written submission in reply):

> The parties themselves set clear boundaries between that part of the agreement of 24 November 1989 that was to be legally enforceable and the greater part that was not. The clause on which the plaintiffs' sue falls within the former part and should therefore be upheld unless contrary to legal principle. The defendants' essential argument is that it is unenforceable for uncertainty. But properly analysed, that argument is flawed. The obligation on which the plaintiffs sue is not in any way uncertain. **It is to reimburse all reasonable costs of, and in relation to, investigation and negotiation.** Obviously the quantification of the obligation could not be undertaken other than retrospectively, but that is not in itself sufficient to amount to uncertainty. Equally clearly, the plaintiffs' obligation in good faith towards the legally enforceable sale is unenforceable for uncertainty. But that lies in the part of the agreement not intended to be legally binding. (emphasis added)

Clause 3.3 of the MOU which provides that in the event of breach of cl. 1 the defendants, at the option of the plaintiffs either pay RM500,000 or forfeit 500,000 of the shares of UCM clearly, in my view cannot be reasonably considered as reimbursement of all reasonable costs in relation to investigation and negotiation. It speaks of compensation and not reimbursement. At most the plaintiffs may stipulate for reimbursement for reasonable costs in relation to investigation and negotiation which is not the case here.

It is my view that the enforceable provisions by way of the first part of the MOU as contended by the plaintiffs' Counsel are clearly unenforceable for the reasons set out by me.

I would conclude that MOU is not a legally binding document as the intention of the parties are to set out the understanding of some preliminary matters to be dealt with prior to the parties' finalisation of the terms and conditions of the formal agreements relating to the transactions thereby contemplated as stated in the MOU. In other words, it is an agreement subject to a 'formal contract to be drawn up and agreed upon' between the parties. This is a clear case of a negotiation the performance of which is completely open-ended.

In the circumstances I dismiss the plaintiffs' claim with costs.

Reported by Ling Hea Hoon